



EX PARTE OR LATE FILED

February 16, 1998

The Honorable William Kennard
Chairman
Federal Communications Commission
1919 M Street, N.W.
Room
Washington, D.C. 20554

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Ex Parte; WT Docket 97-82

Dear Chairman Kennard:

During the past year I have devoted substantial thought to why competition remains elusive in the U.S. telecommunications market and to public policy remedies for this unfortunate state of affairs. It is in this context that I published the attached contribution, "Don't Crush Wireless Innovation" in the *Wall Street Journal* last September. It was my conviction then, a conviction that has only been reinforced by events of the last five months, that the wireless innovators who are licensees in the C block have a major role to play in promoting open competition and innovation in these markets. Since you are about to complete your reconsideration of the September Order on C block financing and since four Commissioners did not have the opportunity to review this subject before, I have taken the liberty to write.

I remarked in the attached article that, while hopes for competition had been pegged on dominant carriers' invasion of each other's turf under the construct of the telecommunications reform legislation, in fact these carriers have chosen instead to consolidate and to fight vigorously in the courts to protect their respective

areas of dominance. Specifically, we have seen a new high water mark for protecting entrenchment via the courts in the recent Texas federal district court decision applying Writ of Attainder law to eviscerate the core provision of the 1996 Act. It is become more profitable for these companies to engage in a debate more appropriate to an advanced constitutional law seminar than it is to take off their gloves and compete in the service of American consumers. Meanwhile, both the popular press and the trade journals have been replete with articles in the last two months remarking on a continuation of oligopoly pricing in the wireless sector.

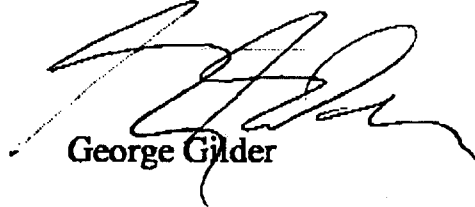
I would like to respectfully suggest that this Commission consider this public policy backdrop in reconsidering the September Order. That Order was highly punitive. It failed to take into consideration the crippling delays imposed on the C bloc companies by new litigation that effectively nullified the key assumption of their bids: that they could lead in deploying new technologies. It certainly did not reflect the vast majority of points of view in the record. At its close, it was heralded by Wall Street analysts as a boon to the stock of incumbents who had succeeded in establishing a new regulatory firewall against rapid further competition.

On reconsideration, there are steps that new entrants urgently need that would address this unfortunate circumstance. The \$1 billion in downpayments of the C block competitors should be fully credited against early interest payments so that these competitors can commence to raise money for the buildout of advanced networks. The clock for repayment of the debt should be reset as of the close of the reconsideration proceeding. No one can dispute that these competitors were left seeking to raise money in the spectrum policy no man's land that existed as Congress attempted to use spectrum allocation as a budget reconciliation tool. Additional steps are also warranted.

I very much appreciate the opportunity to present this point of view. As your schedules permit, I would be very pleased to discuss it further with you.

With best wishes as you embark upon your critical role.

Sincerely,



George Gilder

cc: Commissioner Furcht-gott Roth
Commissioner Susan Ness
Commissioner Michael Powell
Commissioner Gloria Tristani
Mr. Dan Phythyon

Don't Crush Wireless Innovation

By GEORGE GILDER

In the next few weeks the Federal Communications Commission will decide whether the U.S. telephone industry unleashes a new birth of competition, entrepreneurship and innovation.

When Congress completed last year's comprehensive revision of telecommunications legislation—the first in 60 years—pundits foresaw a flowering of new services in the telecommunications marketplace. The Baby Bells were to take on the long distance companies, which in turn were to enter the local phone markets; and both were to barge into cable television services, already beset by direct digital satellite. In this garden of competition, a thousand flowers were to bloom.

Briar Patch of Rules

A little more than a year later, as Frank Gregorski and I predicted on this page, the garden is still bare. The 780,000 words of "deregulation" turned into a briar patch of new rules to be manipulated by the established telephone companies and their allies in the communications bar. Meanwhile, the regional Bell operating companies' investment in their own networks collapsed under the perverse Telric standard (the acronym stands for "total element long-run incremental costs"), limiting what telcos can charge rivals to link to the network or colocate in the regional Bells' central offices. Congress's standard of "competition" effectively meant that no one could win, or even make any money.

Rather than invading one another's turf or upgrading their networks, therefore, long-distance and local-exchange companies have turned to consolidation, the strategy behind the aborted alliance between AT&T and SBC Communications, while MCI sold out to British Telecom. Meanwhile other "locals," such as SBC-Pacific Telesis and Bell Atlantic-Nynex, have expanded their monopoly territories by merging rather than by competing with one another. Instead of seeking new fields of competition, most of the old, wire-based systems have retreated to the familiar domains of the copper cage—some 48 million tons of metal

wire that they have implanted across the country over the past 100 years, and that gives them their local dominance.

The real hope for competition in the local loop is wireless entrepreneurs providing so-called personal communications systems. The ultimate PCS market is not among current cellular customers, but among the one billion wire-line customers in rich countries and the several billion potential phone and computer customers around the globe. In pursuing them, new wireless technologies will release torrents of new demand and new revenues; dramatically higher volumes will more than compensate for the decreases in unit prices. Digital wireless services can un-

panacea for the budget crunch. And so it mandated that the FCC dump huge new spans of spectrum on the market, through an array of at least eight previously unanticipated new auctions. Although the Congressional Budget Office projected that these transactions would yield the awesome sum of \$40.7 billion, in fact the mere announcement crashed the market. The so-called Wireless Communications Service auction in April saw licenses in St. Louis, Minneapolis, Milwaukee, Des Moines, Iowa, and Omaha, Neb., go for just \$1 per person—a fraction of 1% of the value of previous licenses. The result was to devalue the licenses the PCS entrepreneurs had won only a year earlier, in some

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leash huge new growth in telephony, using the electromagnetic spectrum in all its various forms.

Now, however, the FCC is in grave danger of aborting this competition as well. Four years ago, Congress granted the commission authority to auction parts of the broadcast spectrum, giving specific instructions to encourage new entrants to participate in the wireless communications industry. In response, the FCC scheduled the so-called C-Block auction, limiting participation to new entrepreneurial companies and permitting successful bidders to pay over 10 years.

The auction finished on May 6, 1996, amid the euphoria of the Telecom Reform Act enacted a few months earlier. As hoped, a hardy band of entrepreneurs competed aggressively in the bidding, driving prices to more than 2.5 times those paid earlier by the big wire-based players.

Then the trouble began. The FCC took more than a year to complete its licensing of these upstart competitors, giving incumbent wireless-service providers a more than two-year head start. Then the FCC permitted broadcasters virtual carte blanche in their use of their huge grants of free spectrum and anointed special mobile radio companies (formerly dispatch services for taxis, ambulances and other services) as full-fledged cellular players.

At the same time, Congress determined that spectrum auctions should be a

cases to less than one-third of what they had been worth. This crippled the PCS licensees' ability to borrow against the value of their new property to build their innovative networks.

The FCC can straighten out this mess by acting quickly to restructure the debt held by the C-Block bidders. FCC rules permit this step, and it can be done in such a way that taxpayers are kept whole. The key is that, in recognition of the prolonged delay in licensing, the new entrepreneurs should be freed from the interest payments on their debt obligations to the government during the early years of their life cycle. This would allow them aggressively to build out the networks that can finance repayment of the government loans and accumulated interest.

If restructuring isn't possible, the FCC should offer C-Block bidders the opportunity to participate in a speedy reauction, crediting their initial down payments against new bids, as well as offering a credit for build-out commitments already made. But a reauction should only be a last resort, after all restructuring options have been exhausted. It would result in delays of up to two years just to get through the bureaucratic formalities associated with running an auction, which would solidify the dominant position of incumbent operators.

When the FCC licensed first-generation cellular service about 15 years ago, it gave

away one of the franchises in each licensed territory to the incumbent telephone service provider. The predictable consequence was that wireless systems did not even attempt to compete with these companies' monopolies. Instead, wireless was positioned as an adjunct "high mobility" service—in other words, phones for use in cars and when walking around. Today AT&T, GTE and the Bell affiliates control 77% of the U.S. population's access to cellular service and 87% of the PCS licenses in the top 50 U.S. markets.

They have priced their wireless services so high that they can be used by only a fraction of the population. Wireless usage has remained unusually low in the U.S. compared with other developed nations, where the cost of service is much cheaper relative to exorbitant wireline costs. Although wireless often claims as high as 15% market share in the U.S. by the gauge of number of subscribers, the real market share in "user minutes" remains under 2%.

An efflorescence of innovation in communications can be this FCC's legacy. Open wireless platforms, like the platforms distributed by computer networks, can be an engine of economic growth in the next millennium. But current policy dooms the U.S. industry to a long siege of litigation and pettifoggery, financial maneuvers and overseas speculations, together with a tepid rivalry among leviathan telephone companies offering conventional cellular and wireline phone services.

Creative Forces

The hope for the future comes from new competitive entrants with the incentive to bring new ideas and new services to U.S. consumers. Eli M. Noam of Columbia University's Institute for Tele-Information has said: "We all oppose a government industrial policy subsidizing telecommunications. Could we not also agree to oppose a government's effort to punish telecom by extracting these huge payments from the industry?"

By luring entrepreneurs into huge investments and then crashing their markets, the U.S. government has imposed an oppressive tax on some of the most creative forces in U.S. communications. The FCC should right this wrong as soon as possible.

Mr. Gilder is editor of the Gilder Technology Report.

